

ubiquitous fiber facilities; (iv) alternative providers' lack of ubiquitous fiber facilities presents a barrier to special access entry; (v) SBC's Phase II special access prices have increased; (vi) SBC is realizing increasing economies of scale in its provision of special access services subject to price caps; (vii) pricing flexibility triggers should either cover smaller areas or be more difficult to satisfy; and (viii) the discounts SBC offers on special access services are anticompetitive.

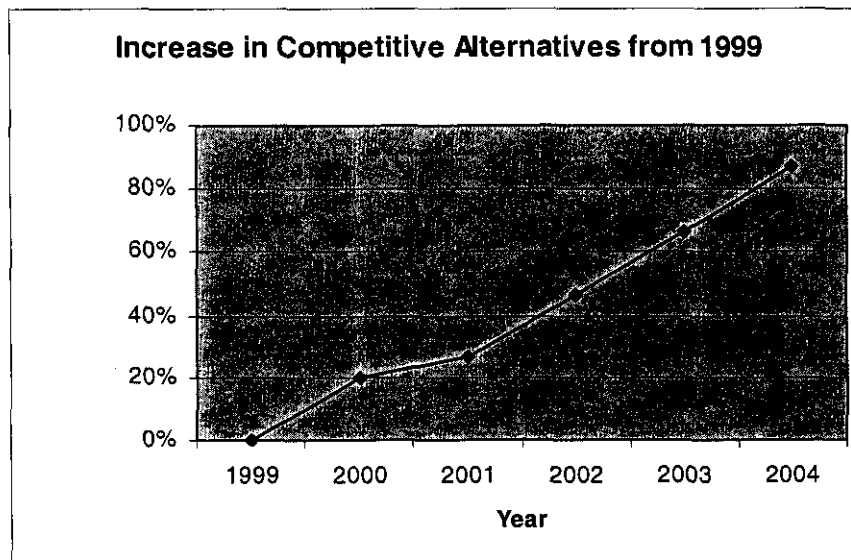
3. As I explain in detail below, each of these allegations is wrong. As I explained in my Initial Declaration and further explain below, competition to provide special access services has continued to grow throughout SBC's traditional regions, and SBC has responded to that competition by effectively lowering its prices and offering its customers additional non-price value. SBC nonetheless continues to lose special access customers to wireline and intermodal competitors, which demonstrably succeed today, as they have succeeded for many years, in overcoming the supposed "barriers to entry" that some commenters allege here without any serious factual foundation. Special access purchasers are thus reaping the rewards of the Commission's pro-competition policy. There is no reason to reverse that course now, no reason to ratchet down prices by regulatory fiat, no reason to make pricing flexibility more administratively burdensome or more difficult to obtain, and certainly no reason to impose prophylactic restrictions on the types of discounts ILECs can offer on special access services.

III. STATE OF SPECIAL ACCESS COMPETITION

A. The Direct Evidence of Substantial and Increasing Competition is Overwhelming

4. As detailed in my Initial Declaration for this proceeding, as well as in the declarations I submitted in the Triennial Review Remand Proceeding,^{2/} SBC has confronted increasingly robust competition in the special access market for several years. Competitors have been building their networks for decades, and now have deployed facilities in markets representing the vast majority of SBC's special access revenues. In MSAs in which SBC has received Phase II pricing flexibility, for example, the number of active competitors has nearly doubled since 1999, as shown below.^{3/}

Figure 1



^{2/} Declaration of Parley C. Casto on Behalf of SBC Communications Inc., filed in WC Docket No. 04-313, CC Docket No. 01-338 on Oct. 4, 2004 ("Casto *TRRO* Initial Decl."); Reply Declaration of Parley C. Casto on Behalf of SBC Communications Inc., filed in WC Docket No. 04-313, CC Docket No. 01-338 on Oct. 19, 2004 ("Casto *TRRO* Reply Decl.").

5. These competitors, which include CLECs, dark fiber providers, cable companies, and fixed wireless providers, offer a wide variety of alternatives to SBC's special access services. As a result, competitive special access providers need not rely on SBC facilities to reach their customers (although they can do so if they wish).⁴ To the contrary, many can and do use self-provided and third-party fiber, collocation hotels, and alternative technologies to bypass SBC's central offices and transmission facilities, either partially or completely.

6. For those businesses and locations that represent the great majority of the special access market, competition (including facilities-based competition) is thriving. All the way back in December 2002, SBC presented extensive evidence to the Commission that CLECs, by their own accounts, had deployed networks that passed a large percentage of the buildings and customers that make up the special access market. Among other things, that evidence showed:

- According to ALTS, competitive carriers had deployed a number of route miles of fiber comparable to that attributed to ILECs nationwide at that time;⁵
- CLECs had claimed to have placed fiber to at least 30,000 different office buildings;⁶
- A CLEC coalition had claimed that competitive fiber reached buildings representing approximately a third of all business lines in the country;⁷ and

^{3/} See Casto Initial Decl. ¶¶ 21-24.

⁴ Indeed, DS1 and DS3 UNEs remain available in all but a tiny handful of the most competitive markets. Those UNEs, which are generally priced well below SBC's actual costs to provide them, often can be used to provide retail special access services.

⁵ Opposition of SBC Communications Inc., filed in RM 10593 on Dec. 2, 2002, at 12 ("SBC Opposition").

⁶ *Id.*

⁷ SBC Opposition at 12-13.

- Covad and MPower said that sufficient competitive transport facilities were available to serve approximately half of their needs.⁸

7. Since then, competition has only grown. As I showed in my Initial Declaration, since 2002, the number of active competitors in SBC's major markets has continued to grow. In fact, special access competition grew faster between 2002 and 2004 than it grew prior to 2002.⁹

8. Indeed, even since I filed my Initial Declaration a month and a half ago, SBC has felt increasing competitive pressure. For example, SBC recently received a request for proposal (RFP) from a large cellular carrier customer which has received an offer from a cable company to provide approximately [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] of the customer's entire [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] special access needs. That customer is demanding extremely steep discounts to keep on SBC's network: [BEGIN CONFIDENTIAL INFORMATION]

[END CONFIDENTIAL INFORMATION] I am not sure if SBC ultimately will be able to keep this business, but I am certain that the customer will end up with a great deal from either SBC or the cable competitor.

9. As another current example of competition in today's special access market, SBC is currently pursuing a special access sale to a growing, regional fiber transport provider based in St. Louis. The customer is itself a wholesale competitor of SBC's, owned by a large, non-RBOC LEC. The customer sells fiber capacity to traditional voice and data providers, CLECs, and similar

⁸ *Id.* at 13.

⁹ *See* Casto Initial Decl. ¶¶ 5-8, 21-26, Fig. 1 and Tables 2-5.

entities. Although the customer owns fiber facilities throughout the central portion of the United States, it also purchases special access services to serve its customers. In this case, the target customer seeks primarily DS1 and DS3 circuits—in Tier 1, Tier 2, and Tier 3 markets throughout SBC's serving area—to link its own customers to collocation sites in both SBC central offices and carrier hotels. In negotiating with this customer, SBC has learned that the customer has been presented with an offer at rates [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] percent below SBC's base rates¹⁰ from a competitor relying at least in part on resold SBC special access services. (Thus, it appears that both SBC's customer and this competitor are wholesale special access providers that offer "ubiquitous" coverage through a combination of their own facilities and purchased services.)

10. The basic fact of substantial and growing competitive entry in the special access market was not seriously challenged in the opening round of comments. Parties arguing for the re-regulation of special access services rely largely on isolated anecdotes and broad, general assertions that are unsupported by specific facts. And when those parties do offer *factual support for their* positions, the data they offer are largely exaggerated, irrelevant, or simply wrong.

11. For example, the ETI White Paper claims that 98 percent of all business premises nationwide are served only by ILECs' facilities.¹¹ But that white paper addresses business premises of all sizes—including the vast majority of small businesses, such as coffee shops, convenience

¹⁰ I use the term, "base rates," as I did in my Initial Declaration, to mean undiscounted month-to-month tariff rates.

¹¹ Competition In Access Markets: Reality Or Illusion, A Proposal for Regulating Uncertain Markets at 16-17 (Economics and Technology, Inc. Aug. 2004) (Attach. A to Ad Hoc Comments) ("ETI White Paper").

stores, and small retailers, that are not special access customers and are thus irrelevant to the state of competition for special access services. Moreover, CLECs have built their fiber rings throughout all of the major metropolitan areas, which contain high concentrations of the largest special access users, and they tend initially to target their facilities deployment to the largest buildings that house customers with the most demand, and then subsequently serve other locations as demand warrants. This makes the ETI study even more meaningless in the context of this proceeding, where the issue is not whether ILECs serve a large percentage of buildings but whether existing regulations, coupled with current and future CLEC competition, constrain ILEC special access pricing, while simultaneously promoting the continued development of competition.

12. T-Mobile's claims of lack of competitive alternatives are likewise flawed. Indeed, they are belied by its own (and other wireless carriers') actions. T-Mobile declarant Chris Sykes claims that T-Mobile buys 96 percent of its base station-central office links from ILECs.¹² Further, T-Mobile states that it "strongly prefers to purchase from one provider all special access links in a connection from a base station to its MSC," leaving ILECs as virtually the sole source of special access services within T-Mobile's services areas.¹³ However, **[BEGIN CONFIDENTIAL INFORMATION]**

¹² Declaration of Chris Sykes on behalf of T-Mobile USA, Inc. ¶ 5 ("Sykes Initial Decl.").

¹³ Comments of T-Mobile USA, Inc. at 9 ("T-Mobile Comments").

¹⁴ [END CONFIDENTIAL INFORMATION] Likewise, as noted above, another major wireless carrier is currently contemplating moving approximately [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] of its special access business to an intermodal competitor in [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]

B. The Barriers to Entry Suggested by Some Commenters are Easily Surmounted, to the Extent They Exist at All

13. Some commenters assert that barriers to entry, such as the difficulties customers allegedly have in switching special access providers¹⁵ or the challenge of building ubiquitous or far-flung networks,¹⁶ mean that competitive entry simply *cannot* exist. The short answer to all of these claims is that competitive entry *has occurred* to a significant and growing degree. To be sure, as in any capital intensive industry, there are costs associated with entry. These costs, however, and the barriers they pose to entry, are greatly exaggerated by CLEC commenters.

14. For example, in their reply comments, WilTel and Sprint argue that the charges and time SBC requires to rearrange or groom special access circuits make it difficult to change from SBC to an alternative provider. These claims rest on mischaracterizations of the grooming process and the costs involved.

¹⁴

¹⁵ See Comments of Broadwing Communications, LLC and SAVVIS Communications Corp. at 16-17, 25-26 (“Broadwing/SAVVIS Comments”); Comments of WilTel Communications, LLC, at 15 (“WilTel Comments”); Comments of Sprint Corp. at 6-7 (“Sprint Comments”).

¹⁶ See Broadwing/SAVVIS Comments at 13-18; WilTel Comments at 12-13.

15. To complete grooming projects efficiently, SBC handles them on a “project” basis. This permits SBC and its customers to plan these requests on a case-by-case basis and to arrange a mutually agreeable due date for the number of circuits the customer desires to groom. SBC has used this approach for many years as customers upgrade their networks and move service to alternative providers, and SBC generally has been able to accommodate its customers’ grooming requests within intervals consistent with the customers’ needs. SBC has done so while also addressing necessary construction, maintenance, and service order activity, all of which are at least as important to customers as their grooming requests.

16. In fact, SBC offers such favorable grooming options and timelines that customers often cannot complete the amount of network grooming offered by SBC, even when they claim that they would like additional grooming capacity. Over the past six months in the Midwest region alone, SBC has groomed more than [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] circuits. SBC has been similarly active in completing grooming requests in its other regions. And, contrary to the suggestion of some commenters,¹⁷ the majority of missed grooming dates are the CLEC’s fault, not SBC’s.

17. Nor do the costs of grooming present a significant barrier. The tariffed non-recurring charges for DS1 grooming are cost-based and, accordingly, vary based on the activity required. They range from \$50 up to approximately \$800 per circuit depending on the amount of work involved. Based on the average prices for DS1 service, carriers effectively recover these grooming costs over a period of between [BEGIN CONFIDENTIAL INFORMATION]

[END CONFIDENTIAL INFORMATION]

¹⁷ See Sprint Comments at 6-7; WiTel Comments at 15.

18. Sprint's argument that the time and costs involved in network grooming represent a significant hurdle is belied by Sprint's own experience. Since 2001, [BEGIN CONFIDENTIAL INFORMATION]

[END

CONFIDENTIAL INFORMATION]

19. As another example, [BEGIN CONFIDENTIAL INFORMATION]

[END CONFIDENTIAL INFORMATION]

20. WilTel's complaint that grooming is too expensive appears to rely on non-recurring charges associated with grooming for *switched* access, which is significantly more costly than grooming special access circuits. In any event, WilTel's argument is inconsistent with the fact that, [BEGIN CONFIDENTIAL INFORMATION]

[END CONFIDENTIAL INFORMATION]

21. Various parties also claim that SBC and other ILECs have a major advantage over their competitors, due to the ubiquity of the ILEC networks. This argument is specious.

22. First, ubiquitous networks are not needed to compete in the *special access* market. Having or not having a fiber loop that connects to a building in one city has no bearing on the ability of a carrier to build a loop to a different building in a different city. Likewise, having or not having a fiber ring in one market has no bearing on the ability to construct a ring in another market. To be sure, some enterprise customers prefer to use a single retail provider for all of their services, but the success of numerous CLECs and IXC's in serving large enterprise customers demonstrates that customers do not demand that this same carrier provide ubiquitous special access service entirely over its own facilities. To the contrary, carriers utilize a variety of options including, but not limited to, self-provisioned facilities, third party facilities, UNEs, and other arrangements to offer end-to-end service to their retail enterprise customers.

23. In this regard, many enterprise customers' operations span the territory of multiple ILECs. With respect to those customers, the CLECs cannot even profess a significant disadvantage. In fact, because ILECs often lack extensive facilities or third-party arrangements outside their own service territories, coverage may favor CLECs in many cases. Certainly, my personal experience has been that SBC often finds itself competing against CLECs with nationwide networks. When that occurs, SBC often finds that it makes more sense to pursue the business using a "buy" strategy than a "build" strategy.

24. Second, ubiquity can sometimes be more of a burden than a benefit. ILECs must operate under "carrier of last resort" and similar regulatory obligations that do not bind CLECs or intermodal competitors. As a result, ILECs often must deploy their networks in areas where it would not otherwise make good business sense. Because CLECs are free to build or buy their network resources in any manner and in any locations they wish, and to pursue or ignore whatever customers they wish, they can use their network resources more efficiently than ILECs—focusing

their time, money, and resources only where their business plans dictate. As a result, the fact that competitors may lack their own network resources in a particular area means only that they have decided not to build there. That does not mean that they could not do so if they wished, nor does it mean that they cannot compete for customers located there.

25. Finally, claims by several special access customers that they must purchase wholesale special access services from a single, ubiquitous provider stand in stark contrast to the actual practices of many of them, and to claims that many of the same customers made in the Triennial Review Proceeding that they prefer to buy services from multiple providers for redundancy reasons, and opt to purchase from competitive providers where they have the choice.¹⁸ Similarly, in this proceeding, some of the parties that complain that ILECs are “often the only game in town” incongruously admit that they purchase special access services “primarily” from alternative providers, which they claim “offer better terms and conditions than the ILECs.”¹⁹

¹⁸ See, e.g., Declaration of Dan J. Wigger on Behalf of Advanced Telecom, Inc., Initial Comments of the Loop and Transport CLEC Coalition, filed in WC Docket No. 04-313, CC Docket No. 01-338, Oct. 4, 2004, ¶ 5; Declaration of Rebecca H. Sommi on Behalf of Broadview Networks, Inc., filed in WC Docket No. 04-313, CC Docket No. 01-338, Oct. 4, 2004, ¶¶ 6, 8; Declaration of David A. Kunde on Behalf of Eschelon Telecom, Inc., filed in WC Docket No. 04-313, CC Docket No. 01-338, Oct. 4, 2004, ¶ 8-10; Declaration of Warren Brasselle on Behalf of Talk America Inc., WC Docket No. 04-313, CC Docket No. 01-338, Oct. 4, 2004, ¶ 7; Declaration of Wil Tirado on Behalf of XO Communications, Inc., WC Docket No. 04-313, CC Docket No. 01-338, Oct. 4, 2004, ¶ 6; Declaration of James C. Falvey on Behalf of Xspedius Communications, LLC, WC Docket No. 04-313, CC Docket No. 01-338, Oct. 4, 2004, ¶ 6; Declaration of Ranier Gawlick on Behalf of Lightship Telecom, Comments of ALTS, *et al.*, WC Docket No. 04-313, CC Docket No. 01-338, Oct. 4, 2004, ¶ 6.

¹⁹ Broadwing/SAVVIS Comments at 23, 26.

IV. TRENDS IN SPECIAL ACCESS PRICING

26. A number of commenters claim that SBC's special access rates in Phase II areas have increased since 2001. They do so by: (i) focusing on SBC's base month-to-month rates while completely ignoring the real discounted prices that customers actually pay for SBC's special access services; and (ii) pointing to the only tariff filing to materially increase SBC's Phase II base rates, which was limited to SBC's legacy Pacific Telesis MSAs, and suggesting—in stark contrast to reality—that it was representative of four years of pricing flexibility. These attempts to obfuscate, however, cannot hide the two crucial facts of SBC's Phase II special access prices. First, and most important, the prices that customers *actually pay* for SBC's special access services in Phase II MSAs have declined substantially since 2001. Second, SBC's aggregate increases in Phase II month-to-month base rates since pricing flexibility was first implemented in SBC's region in 2001 have been less than the rate of inflation. In other words, even SBC's aggregate Phase II *base* rates have declined in real terms during pricing flexibility. And the vast majority of SBC's Phase II base rates have not increased even nominally during pricing flexibility.

A. Prices that Customers Actually Pay for Special Access Services in Phase II MSAs Continue to Decline

27. In my Initial Declaration, I presented an Average Revenue Per Unit (ARPU) analysis which incorporated all Phase II rate increases and all services actually sold at month-to-month base rates. As that analysis showed, the actual prices paid by SBC's customers have declined significantly in Phase II pricing flexibility areas, even without adjusting for inflation. The results of that analysis were normalized to remove the effects of any price reductions due to price cap productivity adjustments, so they accurately reflect only the market pricing discipline in Phase II MSAs. In this reply declaration, I have included the effects of inflation in the analysis, so that

pricing trends can be seen in real dollars. The ARPU analysis shows that, in response to competition, SBC's special access prices per unit have fallen steadily across the Phase II MSAs studied, as shown in the table and diagrams below:

[BEGIN CONFIDENTIAL INFORMATION]

Table 1

Figure 2

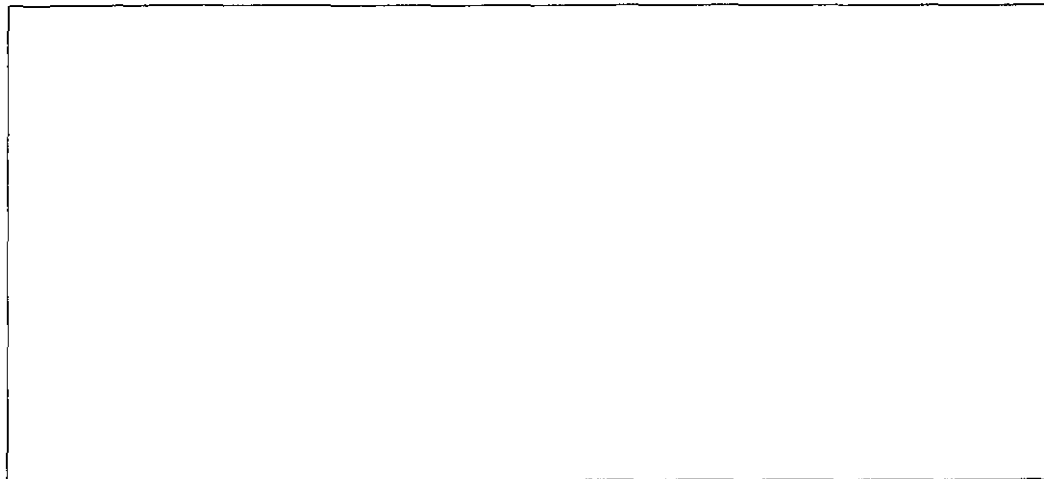
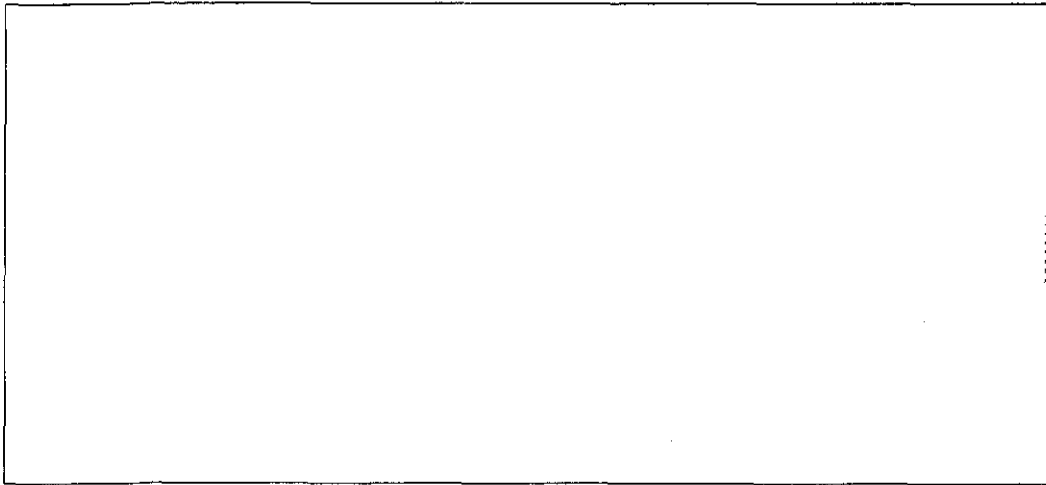


Figure 3



[END CONFIDENTIAL INFORMATION]

28. It is crucial to consider discounts (as my ARPU analysis does) in calculating the rates SBC customers actually pay for special access services, because SBC sells relatively little special access service at its month-to-month rates. Indeed, approximately [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] percent of the special access services SBC provides are subject to a term discount plan, the Managed Value Plan (MVP), and/or an overlay discount plan such as a pricing flexibility contract tariff. In fact, [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] SBC customers currently take advantage of more than [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] pricing flexibility contracts, which in most cases overlay other discounts.

29. A recent pricing flexibility agreement between SBC and a major CLEC provides an excellent example of the irrelevance of base rates to any determination of the real rates carriers pay. That agreement includes credits escalating over five years to [BEGIN CONFIDENTIAL

INFORMATION] [END CONFIDENTIAL INFORMATION] percent off the generally applicable discounted term rates that the CLEC had been paying previously. The agreement also includes a [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] that can result in additional discounts and other benefits if service quality guarantees are not met. In addition, this contract offer includes several other negotiated provisions that benefit the CLEC, [BEGIN CONFIDENTIAL INFORMATION]

[END CONFIDENTIAL INFORMATION] In short, the prices that the CLEC actually pays for SBC special access services have very little to do with SBC's base rates. (Ironically, the customer in this agreement premised in its opening comments on SBC's base rates, rather than the rates it actually pays.)

30. The Uri and Zimmerman study,²⁰ on which many commenters rely, includes only *term* discounts in its calculation of BOCs' "Optional Payment Plan Rates"; it ignores those carriers' volume and contract discount offers,²¹ both of which have become more important since the inception of pricing flexibility. To omit these discounts from the price story distorts reality. For example, the MVP overlay discount alone cuts between nine and 14 percent from customer prices,

²⁰ Noel D. Uri and Paul R. Zimmerman, *Market Power and the Deregulation of Special Access Service by the Federal Communications Commission*, 13 Info. & Comm. Tech. L. 122 (2004) ("Uri and Zimmerman").

²¹ See Uri and Zimmerman at 129.

in addition to ordinary term discounts. Pricing flexibility contract tariffs can offer even greater savings.

31. To support an argument that ILEC special access prices should have declined by even more than they have, Dr. Wilkie, retained by T-Mobile, appears to advocate the use of mileage charges on trans-continental and even inter-continental fiber routes as a point of comparison for end-user channel termination rates in urban areas.²² This comparison is inapt. Though Dr. Wilkie claims to have normalized the data for distance and economies of scale, he entirely ignores the obvious differences between laying fiber along a railroad line across Nebraska and trenching for a meshed network in downtown Los Angeles. The costs of acquiring rights of way and laying conduit associated with urban routes and long haul routes are not remotely comparable. In addition, there is far greater flexibility in planning routes for long-haul fiber: there are more possible paths between Boston and San Francisco than there are between two points in a densely populated urban area. Moreover, local networks are designed differently from trans-continental networks—local networks have far more nodes, which equates to greater overall labor and investment costs. Finally, Dr. Wilkie is drawing his comparative data from shortly after a crash in intercity fiber prices caused by a glut of overbuilding.

32. Finally, even though commenters try to obscure the facts in many respects, no commenter has disputed the fundamental reality of SBC's Phase II special access prices—that the special access prices customers actually pay have gone down, and they continue to go down.

²² Declaration of Samuel J. Wilkie on behalf of T-Mobile USA at 6-8 ("Wilkie Initial Decl.").

B. SBC Generally Has Not Raised Phase II Base Rates

33. Contrary to the suggestions of some commenters, even SBC's month-to-month base rates have declined in real terms during pricing flexibility.

34. Ad Hoc points to a 21 percent increase in some Pacific Bell Phase II DS1 prices in May 2003 as evidence of substantial base rate increases in SBC pricing flexibility areas.²³ It has tried to load this single price increase with far more weight than it can bear.

35. Prior to qualifying for Phase II pricing flexibility, the month-to-month DS1 rates in the legacy Pacific Telesis ("Pacific Bell") MSAs in California were capped substantially below market levels. In particular, those rates were held below the 12-month rates of some of SBC's competitors in those MSAs, and significantly below SBC's month-to-month rates for comparable services in other regions. SBC's one-time rate increase for those services simply represented an effort to move monthly rates closer to market levels and other SBC month-to-month DS1 rates.

36. Notably, this was the only non-trivial special access rate increase by Pacific Bell since January 2001. And, even taking this rate increase into account, SBC's ARPU for DS1 special access services in Phase II MSAs in the Pacific Bell region declined by [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] percent in nominal terms and [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] percent in real terms between 2001 and 2004.

37. Moreover, SBC continued to introduce new and greater discount plans throughout this time period. For example, in May 2003 (the same month as the California monthly rate

²³ Comments of Ad Hoc Telecommunications Users Committee at 20 ("Ad Hoc Comments").

adjustments) SBC introduced a new Term Payment Plan (TPP) that offered discounts off month-to-month rates of up to 45 percent for a 5-year term.

38. SBC's strategy to offer significant price concessions in exchange for commitments to continue using SBC's facilities makes business sense in a market defined by disproportionately fixed costs and increasing competition. SBC's rates must allow it to recoup its up-front fixed costs to provide the service in question. The vast majority of these up-front costs (which include the capital costs of the transmission facilities and equipment used to provide special access services) are not recovered through SBC's up-front, non-recurring charges to the customer (these charges typically recover only the up-front costs of labor associated with activating a service).²⁴ Even where SBC has to build new facilities to serve a customer, SBC's special construction tariff typically does not permit SBC to recover the full cost of such facilities through up-front, non-recurring charges. Consequently, most of SBC's up-front costs of providing special access must be recovered through monthly recurring charges. If SBC has a long-term commitment from a customer, those recurring rates obviously can be lower without exposing SBC to unacceptable risk that it will not recover its sunk costs. In competitive Phase II MSAs, however, month-to-month rates must be considerably higher to create an equivalent likelihood that SBC will recoup its costs, because the customer's expected term is much shorter, since customers buying under these rates could switch to competitive providers at any point. Indeed, the mere fact that a customer *does* buy under these rates is an indicator that it anticipates the possibility of such churn.

²⁴ For example, where SBC has deployed a transmission facility to a single tenant business, its capital investment in that facility may become stranded if that customer goes out of business, moves or switches to an alternative service provider because the facility is dedicated solely to serving that customer and cannot be used to serve another customer.

V. ECONOMIES OF SCALE

39. The contention that ILECs enjoy increasing scale economies in the provision of special access services is inaccurate. While there are scale economies associated with providing special access services, their effect is not uniform across the special access market. Rather, the opportunity to realize scale economies is generally concentrated in fiber-based interoffice transport.

40. First, for channel terminations, where SBC's line growth has been the fastest, the decreases in equipment costs are often offset by the continued increase in the cost of labor to provision and maintain those facilities. In addition, when new demand in channel terminations requires deployment of new facilities, SBC loses scale economies. In fact, in the past 12 months, SBC has had to build to more than [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] end user locations in order to provide service. Each such new build further dilutes SBC's economies of scale.

41. Finally, the scale economies that SBC has realized are already built into SBC's pricing structure, and thus already passed along to customers. For example, the average price of a ten mile DS3 interoffice transport circuit is approximately [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] times the average price of a ten mile DS1 interoffice transport circuit, even though the DS3 provides bandwidth equivalent to 28 DS1s.

VI. PRICING FLEXIBILITY TRIGGERS

42. As I discussed in my Initial Declaration, collocation is a rational, if conservative, benchmark for measuring the level of competition in the special access market. As the Commission has recognized, when a competitor collocates in a central office, it has access to end users through a variety of means, e.g., self provisioned loops, SBC channel terminations, and third-party facilities.

Collocation is not necessary for a competitor to reach end users, however, because wireline CLECs can easily bypass the ILEC's network by interconnecting with each other (and thus indirectly interconnecting with SBC) at carrier hotels,²⁵ or by deploying their own loops. Indeed, intermodal competitors—predominantly cable and fixed wireless—tend not to collocate at all, instead transmitting their traffic to the PSTN, when they must, over IXC facilities. Thus, the presence of a fiber-based collocater guarantees competitive fiber, and at least some pricing discipline, in the MSA, but does not likely reflect the full measure of competition, and the absence of fiber-based collocators does not necessarily mean that the ILEC faces no facilities-based competitors in the special access market.

43. In my Initial Declaration, I also pointed out two of the most important and growing sources of special access competition: cable and fixed wireless.

44. Cable networks currently represent the most robust intermodal alternative to ILEC special access. As I stated in my Initial Declaration, SBC estimates that [BEGIN

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[END CONFIDENTIAL INFORMATION]

of the retail DS1 circuits it loses to competitors are now lost to cable providers.²⁶ Indeed, the Commission itself has found that cable leads in the provision of last-mile access for data services to the mass market. And, as Verizon declarant Lew persuasively established, *all* major cable companies are now actively courting commercial special access customers.²⁷ Continued

²⁵ Indeed, the increase in expanded interconnection cross connects within collocation arrangements (a large majority being DS3 or higher bandwidth) shows that customers are using each other's facilities, as well as their own, to maximize their reach within a geographic area.

²⁶ Casto Initial Decl. ¶ 37.

²⁷ See Declaration of Quintin Lew on behalf of Verizon ¶¶ 34-44 ("Lew Initial Decl.").

encroachment by cable providers in both the retail and wholesale special access space will place growing competitive pressure on SBC.

45. The Commission's collocation-based triggers also do not account for the increasingly significant competition SBC and other ILECs have begun to face from fixed wireless broadband providers. Wireless broadband technology has already obtained a strong foothold in several markets. Cellular providers, which represent a significant percentage of special access demand, have integrated fixed wireless broadband into their networks to backhaul traffic, bypassing traditional wireline special access services. Many analysts and industry participants expect that, now, with the advent of WiMAX technology and the release of a WiMAX industry standard,²⁸ fixed wireless services will soon blossom into a full-fledged alternative for both wholesale and retail special access services. Indeed, competitive pressures—both financial and technological—have led SBC to invest resources in developing its own WiMAX solution. To that end, SBC is currently exploring the use of this technology to provide broadband and special access-like services.

46. Despite this evidence that collocation undercounts facilities-based competitors, some commenters argue that it is not a strict enough proxy to determine pricing flexibility eligibility.

47. For example, Time Warner argues that collocation is used when competitors have concluded that it is uneconomical to build their own end user channel termination connections. To the contrary, competitors do, in fact, collocate in the same central offices where they serve customers directly with their own fiber facilities. Indeed, according to GeoResults data and SBC collocation records, Time Warner has deployed fiber facilities directly to end user buildings in

²⁸ See WiMAX Forum, Technical Information, at <http://www.wimaxforum.org/technology>.

[BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]

percent of the wire centers in which it has collocation arrangements.²⁹

48. In addition, Time Warner argues that a collocater with a line serving one customer counts the same in the metrics as a collocater who has conquered the wire center. Although this is obviously true in a formal sense, it is beside the point in the real world. Carriers do not collocate to serve a single line. In general, carriers collocate where they believe they can and will win enough business to make money—in other words, to be a viable competitor. The fact that a competitor has chosen to collocate in a wire center means that the competitor believes it can compete viably in that area (and not necessarily just in that wire center).

49. WilTel argues that a competitor may collocate for its own purposes without demonstrating it is economical to offer wholesale services to other carriers. Although that point may be true of a few carriers, the evidence compiled in the *TRO* proceeding shows that many carriers (such as Level 3, McCleod, and Time Warner) actually do provide or offer high capacity services to other carriers.³⁰ Moreover, Verizon Declarant Pilgrim likewise confirms that CLECs routinely sell capacity to each other.³¹

²⁹ See also Attachment 1, Map of Time Warner Fiber Collocation, Fiber Routes, and Lit Buildings in the Indianapolis, IN MSA (showing that Time Warner has lit more than [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] buildings in the Indianapolis MSA, [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION]

³⁰ See Reply Comments of SBC Communications Inc., WC Docket No. 04-313 at 33 (filed Oct. 19, 2004).

³¹ See Declaration of Robert Pilgrim on behalf of Verizon, Attach. F at ¶ 16 (“Pilgrim Initial Decl.”).

VII. MSA AS THE MARKET TO DETERMINE PHASE II PRICING FLEXIBILITY

50. Because there seems to be consensus that ILECs should have ubiquitous Phase I pricing flexibility, I focus my declaration in this section on Phase II pricing flexibility.

51. The Commission should avoid adding complexity to the existing pricing flexibility regime. Several commenters suggest, however, that pricing flexibility relief should be granted on a wire center-by-wire center basis. This would be a bad policy decision for several reasons.

52. First, it is not necessary to restrain ILECs from pricing on a basis more granular than an MSA because ILECs tend not to price that way anyway. SBC's contract tariffs are priced MSA-wide, state-wide, or region-wide. Its standard discount tariffs are similarly broad. For example, MVP, which was the product of intense negotiations with SBC's special access customers, offers a region-wide volume discount. And while some customers request term discounts for individual circuits, their *availability* is always at least MSA-wide. Moreover, customers increasingly seek service arrangements that encompass broader geographic areas.

53. Second, as is clear from the fiber maps attached to my Initial Declaration, competitive special access providers do not deploy facilities solely to serve a single building or single wire center. Instead, they build fiber rings that run through dense urban areas as well as suburban office parks with significant telecommunications demand—in other words, they design their network rings to allow them to compete for as much business as possible. They then deploy spurs to ILEC central offices and to individual end user buildings. These ring-and-spur fiber deployments often cover parts of several wire centers, and sometimes even parts of multiple MSAs. The result of this approach to competitive entry is that facilities-based competition quickly spreads from the highest-usage parts of an MSA to the MSA's less dense areas.

54. Moreover, SBC's intermodal competitors—cable and fixed wireless—are particularly well suited to competing in outlying areas. Cable networks already reach these areas, and fixed wireless applications are particularly well suited to serve outlying areas. As a result, a significant and growing number of SBC's competitive bids involve customer locations in outlying areas, and intermodal competitors (particularly cable companies) are involved in those competitive situations with increasing frequency. For example, one of SBC's largest cable competitors bid for a major portion of a large wholesale customer's DS3 business, which includes central and outlying areas of the Dallas and Houston markets. In the Dallas MSA, the bid involved [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] DS3s up to 15 miles outside the core metro area. In the Houston MSA, the bid involved [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] DS3s as far as 28 miles outside the core metro area. SBC was able to win the business by offering [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] discounts for Dallas and Houston, respectively, in addition to the applicable term discounts. The Dallas and Houston examples are not unusual occurrences of the competition SBC experiences outside of core metropolitan areas.

55. Third, requiring ILECs to manage different pricing for the same service on a wire center level would add further and significant complexity for both the customer and the ILEC. This added complexity would distort market forces and prevent SBC and other ILECs from competing on an equal footing. The current structure is already complex. For a given pricing flexibility area, in most cases, the level of relief differs between the transport and end user channel terminations, making it difficult for SBC to respond to customers' needs and competitors' offers. This complexity also makes it difficult for a customer to understand SBC's pricing structure and to make

rational comparisons between the proposals of ILECs and their many competitors. Additionally, SBC has special access circuits with one end of the circuit in a pricing flexibility area and the other end in a non-pricing flexibility area. To support the existing pricing structure, SBC had to expend thousands of hours and millions of dollars to modify its billing and support systems, and to restructure its marketing and sales organizations. Managing pricing flexibility on a wire center basis would exponentially increase SBC's record keeping, reporting, and management overhead, and would significantly complicate the negotiation and implementation of contract tariffs.

56. Fourth, customers want granularity only in regulatory proceedings, where they think it will be accompanied by a government-mandated price cut. Out in the real world, when they are conducting business, they take a very different position. As I stated in my Initial Declaration, when they are sitting at the negotiating table rather than standing in the regulatory arena, many of SBC's customers—including those arguing in this proceeding to limit SBC's flexibility—request a single per-unit price across an entire metro area or larger geographic area. Indeed, even the current pricing flexibility rules constrain SBC from offering the kind of multi-jurisdictional pricing packages our customers continually request. Thus, the commercial behavior of all parties in the special access market indicates that the MSA is a far better proxy of business reality than would be the wire center, which is commercially irrelevant because it is too small to affect major business plan decisions. Any change to segregate the market on a wire center basis would further hinder customers' ability to understand and manage their price per unit, and would hinder ILECs' ability to respond to their customers' needs.

57. Finally, a wire center approach would multiply the work of both ILECs and the Commission in filing and ruling on future petitions for Phase II relief. Historically, SBC has been able to file only one pricing flexibility petition per year because preparing the information to

support those filings requires enormous time and effort. While an individual wire center filing would be slightly simpler than an individual MSA filing, SBC would have to file many more of them, which would make the total effort expended on the process considerably greater. As a point of reference, SBC's territory contains 125 MSAs and approximately 3200 wire centers.

58. Contrary to the suggestion of some commenters, it would be much more difficult and expensive for SBC to incorporate wire center-by-wire center pricing flexibility than wire center-by-wire center loop and transport UNE relief. This is because UNE availability can be "flipped off" at SBC's ordering systems when UNE relief is granted. With special access, however, the question is not whether the service may be *ordered*, but how it is *priced*. So changing special access rates on a wire center basis could not be done by inserting a few lines of code into SBC's ordering systems; it would require a complete and expensive overhaul of SBC's billing systems. Upgrading SBC's billing systems to allow for MSA-wide pricing flexibility has already cost SBC almost [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] Shifting to wire center pricing flexibility would render those enhancements worthless and subject SBC to even greater expenses before it could price on a wire center basis.

VIII. PHASE II END USER CHANNEL TERMINATION TRIGGERS

59. Under the existing pricing flexibility rules, it is difficult to qualify for Phase II pricing flexibility for end user channel terminations. The Commission has recognized that end user channel terminations are naturally subject to less competitive pressure than other special access services.³² It therefore set the benchmarks for attaining Phase II pricing flexibility for end user

³² See Fifth Report and Order and Further Notice of Proposed Rulemaking, *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers*, 14 FCC Rcd 14221, 14278 ¶ 102 (1999) ("Pricing Flexibility Order").

channel terminations at challenging levels. In general, the ILEC must show that 85 percent of its end user channel termination revenues reside in offices with fiber-based collocation.³³ This high bar has led to limited pricing flexibility for channel terminations.

60. SBC has achieved very little Phase II end user channel termination pricing flexibility. The ultra-competitive San Jose and Los Angeles areas represent the vast majority of relief gained to date. SBC has been unable to meet the trigger for other large cities such as St. Louis, Dallas, Houston, Detroit, Cincinnati, Cleveland, Chicago, San Diego, and San Francisco, despite the presence of several major competitors in each of those markets. To this point only [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] percent of SBC's channel termination revenues, predominantly in the Los Angeles and San Jose markets, are subject to Phase II pricing flexibility. SBC's ability to meet the end user channel termination Phase II pricing flexibility trigger thus has been, and continues to be, very limited, even in highly competitive MSAs.

IX. DISCOUNT PRICING PLANS

61. Initially, I would note that SBC's MVP and pricing flexibility contract offers all have been developed at the request of, and in cooperation with, SBC's special access customers. Each of SBC's pricing flexibility contract offers reflects the expressed needs of SBC's special access customers. Most pricing flexibility contract offers are in fact individually negotiated with a specific customer, while others are designed for groups of customers with similar needs. In short, MVP, to which [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] customers subscribe, and pricing flexibility offerings are entirely voluntary, and

³³ *Id.* at 14299 ¶ 150.

most of them reflect extensive, one-on-one negotiations with the customers for whom they have been prepared. As I have described elsewhere, both in my Initial Declaration and in this reply declaration, these customers continually make clear to SBC that they have competitive options; they use those options to extract price and other concessions from SBC during the negotiation process; and many times (unfortunately for SBC), they ultimately take their business elsewhere.³⁴

62. SBC's wholesale customers are wholeheartedly embracing the pricing flexibility the Commission has appropriately granted SBC. SBC has [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] wholesale customers currently purchasing services via pricing flexibility contract tariffs, and SBC is in active negotiations with [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] more wholesale customers. As I discussed in my Initial Declaration, SBC, in early June, had approximately [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] contract tariffs either in effect or in negotiation. This number grows continually as customers seek to negotiate competitive rates, terms, and conditions.

63. Nonetheless, several parties in this proceeding complain about some of the terms and conditions in SBC's MVP and pricing flexibility contract offers. Interestingly, some of the parties most assertive in criticizing SBC's discount offerings, and pricing flexibility arrangements in general, are the same customers who have been the biggest beneficiaries under the contract tariffs they have negotiated to garner significant discounts on the special access services they purchase from SBC.

³⁴ See Casto Initial Decl. ¶¶ 59-75.

64. Several parties complain about minimum annual revenue commitment (MARC) provisions. Their complaints are misleading. MARC provisions are relatively rare in SBC's pricing flexibility contract offers. Out of 122 current pricing flexibility tariffs (i.e., tariffs that are currently effective and to which customers have subscribed), only [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] contain MARC provisions. Thus, additional pricing flexibility discounts are widely available without MARC provisions. And, where MARC provisions appear, they are agreed, negotiated provisions. The MARCs themselves are those that the customers agreed they would achieve.

65. Moreover, a MARC is simply a term and volume commitment. Term and volume commitments are common in contracts in a wide variety of competitive industries and serve reasonable, non-exclusionary purposes. By committing buyers to an agreed term and volume level, such commitments assure a steady flow of revenue, guarantee cost recovery for the facilities required to serve the customer, and reduce sales, marketing, and transactional costs. In exchange for those benefits, SBC offers the customer a lower price than it otherwise would. In fact, if MARC-based pricing flexibility tariffs were banned, customers would ultimately be harmed, because SBC would have to limit its discounts accordingly. In addition, MARC-based contract tariffs allow SBC to tailor its offerings to smaller customers.³⁵

66. The access service ratio serves a similar, but slightly different purpose. It will come as no surprise to the Commission or the parties that SBC views TELRIC rates as unreasonably low. In fact, SBC's TELRIC rates are generally set below cost. When SBC evaluates a pricing flexibility offering, it does so in the context of its overall business with that customer. If a customer

³⁵ See *id.* ¶¶ 60-63.

is willing to limit its UNE purchases, SBC can predict the expected revenues and margins associated with serving that customer with greater certainty, and can protect its ability to earn a reasonable margin on the totality of the service provided to that customer. Once again, by reducing its risk, SBC can offer the customer better service at a lower price on special access than it otherwise could. At the same time, the customer can avoid any uncertainty that might be associated with the transition of DS1 and DS3 UNEs to non-impaired status.³⁶

67. In addition, some parties continue to misconstrue the way the access service ratio works. Contrary to CompTel's suggestions,³⁷ the access service ratio does not provide discounts tied to maintaining traffic on SBC's network. To the contrary, customers are free to self-provision or to use third-party facilities without restriction. And, as noted above, customers are migrating circuits off of SBC's network. The access service ratio limits only the use of SBC UNEs.

68. Not surprisingly, MVP and pricing flexibility offerings reflect the give and take of negotiation in a competitive market, as well as the needs of individual customers. Typical of that environment, the resulting arrangements include prices, terms, and conditions that reflect compromises between the interests of the negotiating parties. In particular, the best prices are often associated with provisions that reduce SBC's costs or risks in providing the service. Do these provisions benefit SBC? Of course they do. Are they anti-competitive? No, they are not. To the contrary, they are the outcomes of negotiation in a competitive environment.

³⁶ See *id.* ¶ 74.

³⁷ See Comments of CompTel/ALTS, Global Crossing North America, Inc. and NuVox Communications at 16-17 ("CompTel Comments").

69. Indeed, some of the complaining parties provide excellent examples of competition at work. For example, SAVVIS, which complains long and loud about SBC's offerings, concedes that it "buys primarily from competitors,"³⁸ which SAVVIS claims "offer better terms and conditions than the ILECs."³⁹ In fact, [BEGIN CONFIDENTIAL INFORMATION]

[END CONFIDENTIAL INFORMATION] That is the hallmark of a competitive environment.

70. Similarly, Broadwing complains about a "winback" provision in its prior pricing flexibility agreement, which required Broadwing to move some business from a competitor back to SBC.⁴⁰ Winback offers are the very essence of competition. Obviously, if there were no competition, there would also be no lost business to win back. Moreover, SBC (like most competitors) constantly tries to broaden and deepen its relationship with its customers, as it tries to pry their business away from its competitors. The customer benefits from these efforts, as the competitors bid for the business that is being contested. As is true of volume commitments, similar arrangements are common in all sorts of competitive markets, and there is no reason to believe that the practice will harm competition in the special access market. In addition, Broadwing fails to mention that the winback provision is *not* a part of its recently executed extension, which runs

³⁸ Broadwing/SAVVIS Comments at 23

³⁹ *Id.* at 26.

⁴⁰ *Id.* at 24.

through 2007 and still offers essentially the same discounts as had the old agreement. Finally, Broadwing also fails to mention that it [BEGIN CONFIDENTIAL INFORMATION]

[END CONFIDENTIAL
INFORMATION]

71. It appears that some complaining parties are trying to use this proceeding to nullify some of the provisions to which they (or other SBC special access customers) have agreed. These parties are asking the Commission, in effect, to rewrite these voluntary, bilaterally negotiated arrangements by eliminating some of the key concessions that allowed the complaining customers to obtain the discounts to which SBC has agreed. Of course, they likely are not eager to give back the discounts that are associated with the concessions they made. This strikes me, as a business person, as fundamentally unfair. Perhaps more importantly, as a matter of regulatory policy, such "relief" would make it very difficult for SBC ever to agree to provide its best prices in a pricing flexibility agreement or other tariffed offering, since the conditions that supported that price would be subject to later unconsented revision.

72. Finally, various parties complain about the broad geographic scope of SBC's pricing flexibility contract offers. To begin, these complaints seem to imply that 13-state commitments are widely, or even universally, required if a customer is to obtain significant pricing flexibility discounts.⁴¹ That implication is false. In fact, SBC has filed many pricing flexibility offerings that are relatively limited in coverage. For example, of [BEGIN CONFIDENTIAL
INFORMATION] [END CONFIDENTIAL INFORMATION] MARC-based agreements,

⁴¹ See, e.g., ATX Comments at 35-36; Broadwing/SAVVIS Comments at 23.

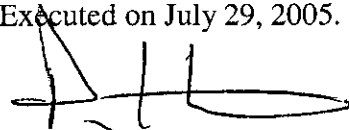
more than [BEGIN CONFIDENTIAL INFORMATION] [END CONFIDENTIAL INFORMATION] cover only a single state. Non-MARC pricing flexibility contract offers also commonly cover limited geographic areas, sometimes as small as a single MSA. Moreover, as I explained in my Initial Declaration,⁴² the parties making this argument have it backwards. In fact, SBC's customers desire geographically broad pricing arrangements because they frequently are able to use their competitive options in the most competitive markets to win concessions covering all markets.

73. This concludes my declaration.

⁴² See Casto Initial Decl. ¶ 68.

I declare under penalty of perjury that the foregoing is true and correct to the best of my knowledge.

Executed on July 29, 2005.

A handwritten signature in black ink, appearing to read 'Parley C. Casto', written over a horizontal line.

Parley C. Casto

CONFIDENTIAL INFORMATION -
SUBJECT TO PROTECTIVE ORDER
IN WC DOCKET NO. 05-25 before the
Federal Communications Commission

Time Warner Fiber Collocation,
Fiber Routes, and Lit Buildings in the
Indianapolis IN MSA

REDACTED - FOR PUBLIC INSPECTION



C

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of)	
)	
Special Access Rates for Price Cap Local)	WC Docket No. 05-25
Exchange Carriers)	
)	
AT&T Corp. Petition for Rulemaking to Reform)	
Regulation of Incumbent Local Exchange Carrier)	RM-10593
Rates for Interstate Access Services)	
)	

REPLY DECLARATION OF
PROFESSOR JOSEPH P. KALT
ON BEHALF OF SBC COMMUNICATIONS INC.

I. INTRODUCTION

A. Witness Identification and Qualifications

1. My name is Joseph P. Kalt. I am the Ford Foundation Professor of International Political Economy at the John F. Kennedy School of Government, Harvard University, Cambridge, Massachusetts 02138. In addition, I work as a senior economist with Lexecon, an FTI Company, 20 University Road, Cambridge, Massachusetts 02138. Lexecon is an economics consulting firm specializing in matters of antitrust and regulated industries. I have previously filed a declaration in this proceeding and my complete curriculum vita was attached to that declaration.

B. Scope of Testimony

2. On January 31, 2005, the Federal Communications Commission (FCC or Commission) issued an Order and Notice of Proposed Rulemaking (NPRM), seeking comment on the appropriate regulation of special access services provided by price-cap local exchange carriers (price-cap LECs) following the current regulatory framework established in the *CALLS Order*. As part of the investigation, on June 13, 2005, various parties filed comments on issues related to the efficacy of the Commission's current price flex standards; the competitiveness of the special access market; and the appropriate post-*CALLS* regulatory regime.

3. I have been asked by SBC Communications Inc. (SBC), to review and comment on various parties' filings. In particular, SBC has asked me to comment on assertions that competition in special access services is impeded by prohibitive barriers to entry; that the level and movement of prices in price-flex regions (and attendant rates of return on special access services) indicate that price-cap LECs are not subject to competition; and that discount programs, including volume and term discounts, are anticompetitive and restrict competition. My initial declaration addressed many of these arguments already, and this reply declaration supplements the points made there.

4. Following the summary below, Section II of my reply declaration addresses arguments concerning an alleged lack of competitive entry in special access markets. Section III focuses on the various assertions that the level and movement of special access prices relative to pre-price flex levels somehow indicate a lack of competition in these markets. Section IV discusses the economics of discount programs and the pro-competitive nature of the programs observed in the special access markets.

C. Summary of Conclusions

5. A number of parties to this proceeding paint a dire picture of the competitive landscape in the special access market. While presenting little data, these parties assert that there is little to no competitive entry in special access markets; that competition has not developed as the Commission intended and expected when the *CALLS Order* was implemented; and that the appropriate course of action is to revert to regulatory practices the Commission appropriately discarded years ago.

6. As I discussed in my initial declaration, the evidence is compelling that the FCC's current special access regulation has been—and continues to be—effective in protecting the public's interest and fostering competition in special access markets. SBC has presented extensive evidence on the steady progress of competitive entry—both by CLECs who collocate in SBC's facilities and by intra- and intermodal competitors that do not collocate—in their price-flex markets. The presence of this type of sustained entry is starkly inconsistent with assertions that price-cap LECs are able to exert significant market power in setting their special access prices in price flex MSAs.

7. Parties focusing on increases in certain prices and purportedly “excessive” rates of return reveal a fundamental misunderstanding of the behavior of competitive markets. Competition is not a guarantee of perpetual decreases in all prices and in all markets, and simply pointing to the direction of a particular price movement as the basis for concluding that a market is not competitive is extremely flawed economic analysis. In a healthy, competitive market, prices move both downward and upward, and it is exactly these price signals that allow markets to function effectively. Indeed, increasing prices (and attendant rates of return) are the very

signals that indicate a tightening of supply and induce both expansion from existing competitors and the entry of new competitors. Overall, moreover, SBC's revenue numbers show substantial decreases in special access prices in Phase II MSAs since the initiation of the Commission's pricing flexibility regime.

II. THE PRESENCE OF SUSTAINED ENTRY IS EVIDENCE THAT SPECIAL ACCESS MARKETS ARE SUBJECT TO COMPETITIVE DISCIPLINE

8. The Ad Hoc Telecommunications Users Committee, WilTel Communications and others assert that, even in special access markets where the Commission's price-flex triggers have been met, competition has not developed (and will not develop) because of the presence of prohibitively high barriers to entry and expansion.¹ These parties suggest that the Commission's measure of "irreversible investment" (i.e., collocation in price-cap LECs' wire centers) is not an appropriate measure of actual barriers faced by competitors seeking to enter the special access market. In particular, they assert that the expense of collocation is just one component of the investment necessary to effectively compete, and that competition is hindered by the cost of gaining access to and installing connections in individual buildings and "the need to surmount the advantages of network ubiquity enjoyed by the incumbent."² Further, parties contend that

¹ Initial Comments of WilTel Communications, LLC (hereinafter, "WilTel Comments") at 11-12; Comments of CompTel/ALTS, Global Crossing North America, Inc., and NuVox Communications (hereinafter, "CompTel/ALTS Comments") at 2-3; Comments of T-Mobile USA, Inc. (hereinafter, "T-Mobile Comments") at 14-15; Comments of the Ad Hoc Telecommunications Users Committee (hereinafter, "Ad Hoc Comments") at 4; and Comments of XO Communications, Inc (hereinafter, "XO Comments") at 9-12. Unless otherwise noted, all Declarations and Comments cited were filed in WC Docket No. 05-25 on June 13, 2005.

² WilTel Comments at 7.

intermodal competition is “not realistic”³ for business applications because intermodal alternatives purportedly are “not capable of supplying a sufficient quantity or quality of service to represent a serious competitive choice for the extensive special access needs of large business customers.”⁴

9. Evidence from the marketplace on the growing number of alternative providers completely undercuts these assertions. As discussed in greater detail in my initial declaration and in the initial and reply declarations of Mr. Parley Casto, the evidence on entry gathered by SBC shows a steady increase in the number of intramodal and intermodal competitors providing special access services across MSA after MSA, both prior to and after SBC obtained Phase II pricing flexibility.⁵ Markets in which SBC has been granted Phase I or Phase II price flexibility have seen particularly robust entry. In Figure 1 of my initial declaration, I report that net entry occurred in thirty-four of the thirty-seven markets studied by SBC from 1999 through 2004. As Figure R-1 indicates and as discussed in my prior declaration, this entry is not confined to large MSAs, but has occurred in markets of all sizes, both before and after the advent of price flexibility. Using SBC definitions of Tier 1 (population of 2 million or more), Tier 2 (population of 500 thousand to 2 million), and Tier 3 (population of less than 500 thousand), Figure R-1

³ *Competition in Access Markets: Reality or Illusion, A proposal for Regulating Uncertain Markets*, Prepared for the Ad Hoc Telecommunications Users Committee, Economics and Technology, Inc. August 2004 (hereinafter, “ETI White Paper”) at 22 (Attach. A to Ad Hoc Comments).

⁴ ETI White Paper at 22.

⁵ Statement of Professor Joseph P. Kalt, on Behalf of SBC Communications, Inc. (hereinafter, “Kalt Initial Decl.”) at ¶¶ 33-39 and Figures 1 and 2.

shows the ubiquity of entry across all Tiers. What The Ad Hoc Committee, WilTel, and others assert to be impossible is, in fact, the norm.

Figure R-1

MSA	1999	2000	2001	2002	2003	2004	Change '99 - '04
Tier 1 (Population > 2 million)							
Chicago, IL	5	7	11	11	12	12	+ 7
Cleveland, OH	5	6	6	5	6	6	+ 1
Dallas, TX	6	8	8	13	12	13	+ 7
Detroit, MI	3	3	5	5	5	6	+ 3
Houston, TX	5	9	7	10	9	12	+ 7
Los Angeles, CA	4	8	10	13	13	13	+ 9
Milwaukee, WI	2	3	5	5	5	5	+ 3
Sacramento, CA	4	6	5	7	7	7	+ 3
San Diego, CA	8	8	8	10	8	9	+ 1
San Francisco, CA	5	6	8	10	10	11	+ 6
St. Louis, MO	2	4	4	4	4	5	+ 3
Tier 2 (Population between 500,000 and 2 million)							
Abilene, TX	0	1	1	2	3	4	+ 4
Austin, TX	5	8	8	8	9	9	+ 4
Bakersfield, CA	0	2	3	3	3	5	+ 5
Champaign/Urbana, IL	1	1	1	1	1	1	--
Columbus, OH	4	4	5	5	7	7	+ 3
El Paso, TX	2	3	3	4	3	3	+ 1
Flint, MI	2	2	2	3	4	4	+ 2
Fresno, CA	2	3	4	5	5	4	+ 2
Grand Rapids, MI	2	2	2	3	5	5	+ 3
Hartford, CT	1	2	3	4	5	5	+ 4
Indianapolis, IN	4	4	6	6	6	7	+ 3
Kansas City, KS	3	3	3	5	6	6	+ 3
Little Rock, AR	3	3	3	4	3	6	+ 3
Lubbock, TX	1	1	1	2	3	3	+ 2
New Haven, CT	2	2	2	2	2	2	--
Oklahoma City, OK	3	3	3	3	3	4	+ 1
Oxnard, CA	1	2	2	2	3	4	+ 3

MSA	1999	2000	2001	2002	2003	2004	Change '99 - '04
San Antonio, TX	4	6	8	8	8	9	+ 5
South Bend, IN	0	0	1	1	3	3	+ 3
Stockton, CA	2	2	2	3	3	3	+ 1
Tulsa, OK	2	2	2	4	5	6	+ 4
Wichita, KS	3	3	3	4	4	4	+ 1
Tier 3 (Population < 500,000)							
Madison, WI	2	3	3	4	5	5	+ 3
Peoria, IL	1	1	1	1	2	2	+ 1
Reno, NV	2	2	2	2	2	2	--
Rockford, IL	0	1	2	3	4	4	+ 4

10. Importantly, entry into the provision of special access services often takes the form of self-provision by would-be customers of ILECs' special access services. For example, MCI's municipal networks "include spurs . . . for connectivity to large buildings and office parks."⁶ Time Warner's fiber network "typically extends beyond the ring all the way to end-users buildings."⁷ MFN "bring[s] our fiber right up to our customers' floors in their buildings and provide[s] them with wall-to-wall seamless connectivity."⁸

11. ETI, on behalf of the Ad Hoc Committee, asserts that intermodal substitutes, such as those provided by cable or fixed wireless companies, do not constitute viable alternatives to

⁶ Competition for Special Access Service, High-Capacity Loops and Interoffice Transport, Submitted by the United States Telecom Association, Prepared for BellSouth, SBC, Qwest, and Verizon, CC Docket No. 96-98 (filed Apr. 5, 2001) (hereinafter, "Special Access Competition Report") at 12.

⁷ *Id.*

⁸ *Id.* at 15-16.

traditional special access services provided by LECs.⁹ These claims, however, are inconsistent with actual, observed competition in the industry. As noted in Mr. Casto's initial declaration on behalf of SBC, cable companies (for example) are able to provide a wide spectrum of bandwidths (from DS1 to OC48) to special access customers and compete with a large proportion of traditional LEC special access service offerings.¹⁰ The presence of intermodal competition is not surprising. Cable providers, for example, are spread broadly across American cities and possess the necessary bandwidth to meet business customers' needs—including CLECs' needs. For companies such as Cox, Time Warner, Comcast, and others, expansion into small, medium and large business service with high-quality, high-capacity products represents a clear avenue of strategic development.¹¹

12. Case evidence indicates that intermodal substitutes, in fact, have success in winning business from price-cap LECs. Many cable companies are beginning to actively seek small and mid-size business customers. Cox Business Services, a division of Cox Communications, reports that it has invested more than \$250 million in its fiber optic network since 1996, introduced innovative services packages in an attempt to win commercial data and telephony business, and won the business of several large customers, including Boeing, Intrust

⁹ ETI White Paper at 22-24.

¹⁰ Declaration of Parley C. Casto, on Behalf of SBC Communications, Inc., June 13, 2005 (hereinafter, "Casto Initial Decl.") at ¶ 37-43.

¹¹ "Cox Business Services Answers Call for Flexible Telecommunication Solutions For Small Businesses," <http://www.coxbusiness.com/pressroom/pressreleases/2004-0405.html>, April 5, 2004; "Comcast, Level 3 To Beef Up National Fiber Infrastructure," *available at* www.advancedpipeline.com/ipbusiness/55300180;jssesoid=TJ, December 7, 2004; Road Runner Business Class, Integrated High-Speed Internet Solutions for Businesses large and Small *available at* <http://www.rrbcaustin.com>.

Bank, and government and educational institutions.¹² Similarly, Comcast has made significant investment in expanding its fiber network, entering into an agreement with Level 3 Communications and committing to spend \$100 million to “enhance [its] ability to deliver new and innovative services, such as . . . advanced phone services.”¹³

13. In the case of fixed wireless service, providers such as XO Communications and NextWeb are touting major pushes into fixed wireless service offerings for the business market.¹⁴ NextWeb, for example, claims that “[a] company that uses PacBell or SBC copper could use our wireless capability to bring new products to market not tied to the limitations of DSL.”¹⁵ NextWeb reports that it can install in a few days video conferencing or VoIP running over a 2 Mbps wireless connection at half the cost of a T1, and its services scale up cost-effectively for individual customers to 10 Mbps (for which it asserts there are no landline equivalents except DS3). Moreover, further fixed wireless entry is a highly attractive venture, with NextWeb reporting wholesale margins above 35%.¹⁶

¹² Jerry Siebenmark, *Cox’s Commercial unit wins new business, competitors undaunted*, Wichita Bus. J., Oct. 20, 2003, at 5. See also, Cox Press Release: Cox Business Services Answers Call for Flexible Telecommunication Solutions for Small Businesses (Apr. 5, 2004), available at <http://www.coxbusiness.com/pressroom/pressreleases2004-2005.html>.

¹³ “Comcast, Level 3 To Beef Up National Fiber Infrastructure”, <http://www.advancedpipeline.com/ipbusiness/55300180>, December 7, 2004.

¹⁴ Khali Henderson, *Fixed Wireless Round Two: Metro Wholesalers Step Back in the RF Ring, Phone+*, February 2004, available at <http://www.phoneplusmag.com/articles/421carrier01.html>.

¹⁵ *Id.*

¹⁶ *Id.*

14. In short, it is clear that cable and other forms of intermodal entry are reshaping the special access market—and there is no evidence that the ILECs have any power to stop this trend.

15. A key conclusion to be drawn from the foregoing is that there are no insurmountable barriers to entry in the special access service market that meaningfully impede the progress of competition. Anecdotal assertions about a handful of instances where individual parties suggest competitive options are not available are insufficient to conclude that the overall regulatory regime is ineffective and in need of significant modification.

16. This robust entry tells us that the market for special access services is generally and widely subject to entry and its disciplining impact. Indeed, under such conditions, the very threat of entry forces competitive responses from incumbents, who find it necessary to lower prices¹⁷ or improve their products, or both, in an effort to retain customers. The result is well-functioning markets that increasingly rely on the forces of competition, rather than regulation, to set prices efficiently.¹⁸ The Price Flex/*CALLS* regime provides for this transition and represents an appropriate approach to the regulation of special access service pricing.

III. ASSERTIONS THAT SPECIAL ACCESS PRICES ARE NOT SUBJECT TO COMPETITIVE DISCIPLINE ARE INCONSISTENT WITH THE EVIDENCE

17. Numerous parties assert that purported increases in some prices for some special access services are evidence that competition in special access markets does not exist. They then call for the re-imposition of various forms of price regulation as a mechanism for returning special access prices to so-called ‘just and reasonable’ levels. These parties generally point either

¹⁷ This is, in fact, what we have seen in the special access market. *See infra* ¶ 27.

¹⁸ *See* Kalt Initial Decl. at ¶ 35-37.

to supposedly “excessive” prices for special access services in price flex MSAs¹⁹ or to evidence of “excessive” rates of return purportedly earned by ILECs on special access services.²⁰

18. These claims are unsound. First, as Mr. Casto and Mr. Toti discuss in their declarations, substantial problems exist with both the price and rate-of-return data used by these parties. In fact, given the extensive competitive entry and sustained presence of new competitors that we see in Phase II MSAs, it is economically incoherent to assert that prices are undisciplined by competition. Even taken at face value, moreover, none of the arguments made or the information presented regarding special access prices or accounting rates of return provides a basis for concluding that the current regulatory framework has been ineffective or that the existing triggers are permitting ILECs full pricing flexibility in markets that are not workably competitive.

19. **Prices.** Before addressing the specific “evidence” proffered by some parties to support claims that purported increases in special access prices demonstrate that the market is not competitive, it is necessary to debunk the premise underlying these claims—that, in competitive markets, prices only go down. As I explained in my prior declaration and above, it is not true that prices only fall in competitive markets. For example, in markets with rapidly increasing demand, prices often rise until sufficient entry occurs to return supply and demand to equilibrium. Likewise, if a pre-existing price-cap price had been set artificially low relative to market conditions, prices in a well-functioning market would be expected to increase when price

¹⁹ George S. Ford and Lawrence J. Spiwak, Phoenix Center Policy Paper Number 18: *Set It and Forget It? Market Power and the Consequences of Premature Deregulation in Telecommunications Markets* (July 2003) (hereinafter, “Phoenix Center Policy Paper”).

²⁰ See, e.g., ETI White Paper at 27-35.

caps were removed or eased.²¹ As Mr. Casto notes, that is precisely what appears to have occurred in those occasional instances in which SBC's undiscounted base rates exceed 2001 levels for certain special access services in particular regions after receiving upward pricing flexibility.²²

20. Increases in prices after price caps are removed in such circumstances most decidedly are *not* evidence that pricing flexibility is inappropriate or that price flex markets are not workably competitive. In fact, keeping ILEC prices at such artificially low levels, or rolling them back to even lower levels (as a number of parties now advocate),²³ would be highly distortive—discouraging entry by inter- and intramodal competitors and encouraging customers to overuse ILEC special access services.

21. Moreover, even under the best of circumstances, prices set under price-cap regulation are simply a proxy for competitive prices. They are a regulatory body's best approximation of the outcome that would be achieved by a competitive market.²⁴ It is not reasonable or practical to expect that a regulatory body can respond to changes in market forces and adjust prices as quickly or effectively as a competitive market. As time passes and the conditions in place at the time the price cap was established change, price-cap prices—even if initially efficient—are likely to stray farther and farther from the price that would be set through

²¹ See Kalt Initial Decl. ¶ 69.

²² See Casto Reply Decl. at ¶ 38.

²³ See Ad Hoc Comments at 37-38; T-Mobile Comments at 20-21; WilTel Comments at 16-18; CompTel/ALTS Comments at 21-28.

²⁴ Kalt Initial Decl. at ¶ 20.

competition. If inputs become more expensive or demand increases, regulated prices will fall below competitive levels. In such cases, removal or easing of price caps can be expected to result in prices that increase (i.e., toward competitive levels).

22. In addition to ignoring the economic reasons why prices under Price Flex would sometimes increase, T-Mobile and XO Communications proffer two statistical “regression” analyses that purport to show evidence of anticompetitive pricing for special access services.²⁵ In evaluating the rigor of these analyses and their usefulness as diagnostic tools, it is important to note that most ILECs have only recently achieved full Phase II price flexibility in affected MSAs, and the MSAs in which SBC has obtained Phase II flexibility account for only [WCPHD Insert Begin Confidential Information ▼] of SBC’s [WCPHD Insert End Confidential Information ▲] special access revenues from end-user channel terminations. Thus, the data available to be studied in these regressions are quite limited. Inferences drawn from such limited data are not reliable.

23. For its part, T-Mobile submits a regression analysis by Simon Wilkie that purports to show that ILEC prices for special access transport are significantly above competitive levels based on a comparison with purportedly competitive benchmark prices. These are derived only indirectly—from rates charged by interstate long distance carriers for long-haul transport between New York and Los Angeles. Apart from the methodological errors that I describe below, Wilkie’s analysis cannot be relied upon for the simple reason that his comparison of rates for transcontinental transport mileage to rates for end-user channel terminations in urban areas is a wholly inapt comparison. As Mr. Casto points out, Dr. Wilkie ignores the obvious difference

²⁵ See XO Comments at 5-7; T-Mobile Comments at 10; Declaration of Simon J. Wilkie on Behalf of T-Mobile USA, Inc. (hereinafter, “Wilkie Decl.”) at 9.